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CREDIT OPINION

8 October 2020

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# Louisville & Jefferson Co. Metro. Govt., KY

Update to credit analysis

## Summary

Louisville & Jefferson County Metro Government, KY (Aa1 stable) benefits from a growing, sizeable and regionally significant tax base that serves as a major economic hub in the Commonwealth of Kentucky (Aa3 stable). Resident income levels are healthy, although slightly below the medians for the rating category. Louisville Metro's reserve and liquidity levels are satisfactory and, while they fall short of the national medians for the Aa1 rating category as a percentage of revenue, they have historically been stable, supported by conservative budgetary practices and adherence to formal fiscal policies. The government's credit profile also reflects manageable debt and pension burdens.

## Credit strengths

» Sizeable and growing tax base serving as a regionally important economic hub

» Stable financial operations

» Manageable debt burden

## Credit challenges

» Lower reserves and liquidity relative to national peers

» Resident income levels below Aa1 median

» Higher pension burden compared to medians for the rating category

## Rating outlook

The stable outlook reflects the improving and regionally important local economy and the likelihood that reserves and liquidity will remain stable due to management's willingness to implement expenditure reductions to maintain structural balance.

## Factors that could lead to an upgrade

» Material and sustained improvement in reserve and liquidity levels

» Substantial tax base growth and expansion coupled with improvement in resident incomes

» Reduction in debt burden

## Factors that could lead to a downgrade

» Reduction in operating flexibility and narrowing reserve levels

» Material contraction in tax base and weakened income levels

» Substantial increase in debt burden

## Key indicators

Exhibit 1

| Louisville & Jefferson Co. Metro. Govt., KY | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|
| Economy/Tax Base | | | | | |
| Total Full Value ($000) | $81,876,791 | $86,326,372 | $89,280,860 | $95,908,835 | $97,560,815 |
| Population | 755,809 | 759,724 | 764,378 | 767,154 | 770,517 |
| Full Value Per Capita | $108,330 | $113,629 | $116,802 | $125,019 | $126,617 |
| Median Family Income (% of US Median) | 95.3% | 95.3% | 96.8% | 95.2% | 95.2% |
| Finances | | | | | |
| Operating Revenue ($000) | $654,871 | $682,616 | $772,072 | $719,373 | $768,319 |
| Fund Balance ($000) | $92,880 | $104,213 | $103,110 | $106,259 | $108,676 |
| Cash Balance ($000) | $77,015 | $89,652 | $94,880 | $86,936 | $59,945 |
| Fund Balance as a % of Revenues | 14.2% | 15.3% | 13.4% | 14.8% | 14.1% |
| Cash Balance as a % of Revenues | 11.8% | 13.1% | 12.3% | 12.1% | 7.8% |
| Debt/Pensions | | | | | |
| Net Direct Debt ($000) | $491,967 | $636,152 | $645,172 | $687,340 | $753,581 |
| 3-Year Average of Moody's ANPL ($000) | $1,240,905 | $1,263,546 | $1,411,925 | $1,551,740 | $1,651,318 |
| Net Direct Debt / Full Value (%) | 0.6% | 0.7% | 0.7% | 0.7% | 0.8% |
| Net Direct Debt / Operating Revenues (x) | 0.8x | 0.9x | 0.8x | 1.0x | 1.0x |
| Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%) | 1.5% | 1.5% | 1.6% | 1.6% | 1.7% |
| Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x) | 1.9x | 1.9x | 1.8x | 2.2x | 2.1x |

*Source: Louisville Metro Audited Financial Statements, U.S. Census American Community Survey, Moody's Investors Service*

## Profile

Louisville Metro is an important regional metropolitan center located in the bluegrass region of the Commonwealth of Kentucky (Aa3 stable), approximately 80 miles west of Lexington-Fayette Urban County Govt., KY (Aa2 stable), that supports a variety of industries including manufacturing and logistics. Louisville Metro encompasses 397.7 square miles and has a 2018 population of 767,154 according to the most recent U.S. Census American Community Survey, which represents a 4.3% increase from 2011.

## Detailed credit considerations

### Economy and tax base: sizeable and regionally significant tax base

Louisville & Jefferson County Metro Government's sizeable tax base will continue to experience steady growth, driven by new development and property value appreciation. The tax base grew by 1.7% in fiscal 2019 to $97.6 billion (combined estimated actual value of the Metro area and Urban Services District), which is large compared to the national medians for the Aa1 rating category.

Louisville Metro serves as a major employment hub for residents of Jefferson County and surrounding adjacent areas of the Commonwealth, as well as southern Indiana. The local economy is diverse, but largely driven by manufacturing, transportation, healthcare, and various professional services given the city's favorable access to several interstate highways (I-65, I-64 and I-71). Major employers include United Postal Service, Inc. (UPS, A2 negative), Ford Motor Company (Ba2 negative), GE Appliances (General Electric Company, Baa1 negative), and Humana, Inc. (Baa3 stable). Recent announcements include expansions at UPS' Centennial Hub/ Worldport Facility, a $750 million investment set to create 1,500 new jobs, and a $62 million investment by GE Appliances that is slated to create 260 jobs.

Resident income levels within Louisville Metro are healthy yet below the national median for the rating category, with median family income equal to 95.2% of the US in 2018. Unemployment rates have historically hovered below the state and national rates. Unemployment has improved since peaking in April because of the impacts of the coronavirus as Kentucky progresses through its phased reopening plan. The August 2020 unemployment rate of 7.9% is in-line with the state (7.5%) and slightly below the national (8.5%) rates for the same period.

The coronavirus is driving an unprecedented economic slowdown. We currently forecast US GDP to decline significantly during 2020 with a gradual recovery commencing toward the end of the year. Local governments with the highest exposure to tourism, hospitality, healthcare, retail, and oil and gas could suffer particularly severe impacts.

### Financial operations and reserves: stable financial operations; satisfactory reserves and liquidity

Louisville Metro's financial position will remain stable due to conservative financial management, demonstrated willingness to make budgetary adjustments in an effort to maintain structural balance, and continued tax base growth. Total operating fund balance (inclusive of the general and debt service funds) totaled $113.4 million, or 14.8% of combined operating fund revenues at fiscal year-end 2019. Available operating fund balance (total less non-spendable and restricted amounts) was similar at 14.1%, which is below the national Aa1 median as a percentage of revenues. Positively, available operating fund balance has remained stable over the past five fiscal years, averaging 14.4% of revenues.

Unaudited results for fiscal 2020 show the year ending with level fund balance. Management reports that revenues were tracking ahead of budget prior to the coronavirus pandemic, but due to the push back of the corporate tax deadline, which delayed the receipt of certain revenues into fiscal 2021, as well as certain expenditure savings, management does not anticipate a material shift in fund balance at fiscal year-end 2020. For fiscal 2021, management revisited the budget in light of the pandemic, building in conservative revenue assumptions and additional contingencies. At this time, management does not anticipate any material change to fund balance and liquidity levels by fiscal year-end.

Social unrest poses some fiscal and governance risks for Louisville Metro. The government recently agreed to pay a $12 million settlement to Breonna Taylor's family to settle a wrongful death lawsuit and to implement police reform, neither of which are expected to have a material impact on the city's overall financial position. Insurance will cover $5 million of the total settlement payout, with the remainder coming from a combination of the government's self-insured trust fund and risk management fund.

The government's primary revenue sources are occupational license fees (inclusive of a payroll withholding, a net profits tax, and an insurance premiums tax) and property taxes, which represented approximately 58% and 23% of operating fund revenues in fiscal 2019, respectively.

#### Liquidity

Louisville Metro's operating funds (inclusive of both the general and debt services fund) reported net cash and investments of $59.9 million at fiscal year-end 2019, or a satisfactory 7.8% of combined operating fund revenues, which is below the national Aa1 median as a percentage of revenues. The fiscal 2019 ending cash position represents a slight decline from the prior year due to the use of available cash for capital projects. This use of cash was ultimately reimbursed with a portion of the proceeds from a bond issuance that occurred subsequent to fiscal year-end. Operating fund cash has historically averaged around 12.0% of revenues.

### Debt and pensions: debt burden will remain manageable despite additional borrowing plans

Louisville Metro's direct debt burden will remain manageable, despite future debt plans. The government's direct debt burden represents 0.8% of fiscal 2019 full valuation, which is a level comparable to the national medians for the Aa1 rating category. The city's net direct debt reflects 98% support from the Kentucky Administrative Office of the Courts (AOC) on the city's Series 2007A lease revenue bonds.

The fiscal 2021 capital budget authorized $78.9 million of additional general obligation debt for various capital improvements and economic development initiatives. In addition, approximately $46.4 million in bond authorizations remain to be issued from the fiscal 2019 and 2020 capital budgets. Despite these future debt issuance plans, Louisville Metro's overall leverage will remain manageable and in-line with the rating category due to continued tax base growth and amortization of outstanding debt.

In 2008, the Kentucky Economic Development Authority issued $350 million of revenue bonds to fund the acquisition, development, construction and financing of an arena in downtown Louisville. Pursuant to an ordinance adopted by the Metro Council, the city agreed to pay up to $309 million to the Louisville Arena Authority for debt service on the bonds over a 30-year period. The authority refunded the 2008 revenue bonds in 2017 and entered into a new agreement with Louisville Metro where they agreed to pay $10.8 million annually directly to the trustee until the earlier of 2054 or until the debt is repaid.

**Debt structure**
All of the government's debt is fixed rate and amortized over the long-term.

**Debt-related derivatives**
The government is not party to any interest rate swaps or other derivative agreements.

**Pensions and OPEB**
Louisville Metro administers two closed single-employer pension plans, the Policemens' Retirement Fund and the Firefighters' Pension Fund. Additionally, the government participates in the Kentucky County Employees' Retirement System (CERS), a multi-employer cost sharing pension plan administered by the Kentucky Retirement System.

The total pension contribution for fiscal 2019 totaled $69.2 million, which is below the tread water amount (the amount required to prevent the unfunded liability from increasing based on plan assumptions).

Moody's adjusted net pension liability (ANPL) is our measure of a local government's pension burden that uses a market-based interest rate to value accrued liabilities. The government's ANPL has averaged $1.7 billion over the last three years, representing 2.1 times operating revenues, which is slightly above the national medians for the rating category. Our ANPL is based on a discount rate of 4.14%, compared to the discount rate of 6.26% used to calculate the reported GASB net pension liability of $1.0 million.

Louisville Metro also provides employees with other post-employment benefits (OPEB) through a mutli-employer defined benefit plan administered by the state (CERS). The Moody's adjusted net OPEB liability was $509.1 million at fiscal year-end 2019. The OPEB contribution in 2019 totaled $26.1 million.

Total fixed costs (inclusive of pension and OPEB contributions and debt service) account for 24% of revenues in fiscal 2019. Total long-term liabilities (adjusted pension and OPEB liabilities for fiscal 2019 and net direct debt burden) represent 3.0% of 2019 full value.

## ESG considerations

### Environmental
The local government sector overall has low exposure to environmental risks. Environmental considerations are not material to Louisville Metro's credit profile. According to data from Moody's affiliate Four Twenty Seven, the government's total average exposure to the projected rate of change of five climate risk factors is mid-ranged compared to other municipalities nationwide. Of the physical climate risks Four Twenty Seven evaluates, the highest exposure is to extreme rainfall and heat stress. This exposure is partially mitigated by several factors, including management's maintenance of adequate reserves, proactive financial and capital planning, and federal government support for disaster recovery costs via FEMA.

### Social
Social issues, which include demographics, labor force, and income metrics, are material to the government's credit quality and are incorporated by way of full value per capita and median family income. While social issues do not currently pose a credit risk, we will continue to monitor a variety of factors such as demographics, income levels, population trends and employment levels, as these remain important key credit metrics.

We regard the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety. The government is not susceptible to immediate material credit risks related to coronavirus. The longer-term impact will depend on both the severity and duration of the crisis. The situation surrounding coronavirus is rapidly evolving. If our view of the credit quality of the government changes, we will update the rating and/or outlook at that time.

### Governance

Like issuers across every sector, governance considerations are material to Louisville Metro's credit quality. The government will continue to benefit from strong management, conservative budgeting practices, and adherence to formal fiscal policies. Louisville Metro is governed by a 26 member council elected to staggered, four-year terms and a mayor elected to a four-year term. The government has a formal policy to maintain unassigned fund balance at one to two months of budgeted general fund expenditures.

Kentucky cities have an institutional framework score of "Aa," which is strong. Property and occupational license (payroll and gross profits) taxes, the primary revenue sources, tend to be highly stable and predictable. Cities have moderate revenue-raising ability and can increase property taxes by 4% annually, with any increase above 4% subject to voter recall. Cities with populations of 15,000 and above also have a property tax cap of $1.50 per $100 of assessed value, however cities typically have substantial headroom under this limit. Cities with population of 1,000 or higher also have the ability to levy an occupational license tax. The occupational tax rate is unlimited for cities with populations up to 300,000 and set at 1.25% for larger cities (cannot be increased or decreased). Operating expenditures for cities tend to be highly stable and predictable and cities have a moderate ability to reduce them given a limited presence of unions and moderate fixed costs, which are driven by debt service and pension costs and are generally less than 25% of expenditures.

## Rating methodology and scorecard factors

The US Local Government General Obligation Debt Rating Methodology includes a scorecard, a tool providing a composite score of a local government's credit profile based on the weighted factors we consider most important, universal and measurable, as well as possible notching factors dependent on individual credit strengths and weaknesses. Its purpose is not to determine the final rating, but rather to provide a standard platform from which to analyze and compare local government credits.

Exhibit 2

**Louisville & Jefferson Co. Metro. Govt., KY**

| Scorecard Factors and Subfactors | Measure | Score |
|---|---|---|
| Economy/Tax Base (30%) [1] | | |
| Tax Base Size: Full Value (in 000s) | $97,560,815 | Aaa |
| Full Value Per Capita | $126,617 | Aa |
| Median Family Income (% of US Median) | 95.2% | Aa |
| Notching Factors:[2] | | |
| Institutional Presence | | Up |
| Regional Economic Center | | Up |
| Finances (30%) | | |
| Fund Balance as a % of Revenues | 14.1% | A |
| 5-Year Dollar Change in Fund Balance as % of Revenues | 3.9% | A |
| Cash Balance as a % of Revenues | 7.8% | A |
| 5-Year Dollar Change in Cash Balance as % of Revenues | -0.8% | Baa |
| Management (20%) | | |
| Institutional Framework | Aa | Aa |
| Operating History: 5-Year Average of Operating Revenues / Operating Expenditures | 1.0x | A |
| Debt and Pensions (20%) | | |
| Net Direct Debt / Full Value (%) | 0.8% | Aa |
| Net Direct Debt / Operating Revenues (x) | 1.0x | A |
| 3-Year Average of Moody's Adjusted Net Pension Liability / Full Value (%) | 1.7% | Aa |
| 3-Year Average of Moody's Adjusted Net Pension Liability / Operating Revenues (x) | 2.1x | A |
| Notching Factors:[2] | | |
| Unusually Strong or Weak Security Features | | Up |
| | Scorecard-Indicated Outcome | Aa1 |
| | Assigned Rating | Aa1 |

[1] Economy measures are based on data from the most recent year available.
[2] Notching Factors are specifically defined in the US Local Government General Obligation Debt methodology.
*Source: Louisville Metro Audited Financial Statements, U.S. Census American Community Survey, Moody's Investors Service*

REPORT NUMBER 1248787

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